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RUEHBR/AMEMBASSY BRASILIA 7899
RUEHRI/AMCONSUL RIO DE JANEIRO 0343
RUEHSG/AMEMBASSY SANTIAGO 1947
RUEHBU/AMEMBASSY BUENOS AIRES 3426
RUEHCV/AMEMBASSY CARACAS 1194
RUEHLP/AMEMBASSY LA PAZ JUL QUITO 1974
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SENSITIVE
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CH, PE, EAID
SUBJECT: SFRC STAFFDEL examines transparency
in Peru's extractive industries

SENSITIVE BUT UNCLASSIFIED HANDLE ACCORDINGLY

¶1. (SBU) SUMMARY. Senate Foreign Relations Committee Staff Members Carl Meacham and Brooke Daley visited Lima May 25-31 to discuss the state of transparency in Peru's extractive industries. Meetings with government officials, non-government organizations (NGO), and private sector executives all emphasized that Peru is making significant gains in supporting transparency and combating corruption. The inability of local governments to effectively invest the mining royalties being generated, however, is fueling citizen frustration and local conflicts. END SUMMARY.

EITI IN PERU

¶2. (SBU) Meacham and Daley spent five days in Peru meeting with Government of Peru (GOP) officials, civic watchdog groups, donors, and mining company representatives to discuss the state of transparency within Peru's extractive industry. Peru is one of four countries piloting the Extractive Industries Transparency Initiative (EITI). EITI was launched in 2002 by Prime Minister Tony Blair to encourage resource-rich countries to publish and verify company payments and revenues from oil, gas, and mining to improve transparency and accountability.

¶3. (SBU) Peru's EITI program began in 2006. At the national level the EITI Working Group, comprised of representatives from civil society, the mining sector, and the Ministry of Energy and Mines, is supported by the World Bank. The U.S. government-funded EITI program, totaling \$445,000 and launched in 2008, is a collaborative effort that brings together USAID, Canada, Britain, the International Finance Corporation, private sector companies, and NGOs. Jointly funded efforts are focused in the five regions where mining is most active and the majority of royalties are generated. The program is designed to ensure that resources generated by the extractive industries are invested transparently in programs that meet citizens' needs. Staffers were interested in understanding the impact of extractive industries on the Peruvian economy, the degree of transparency in revenues being generated, and whether U.S.-supported efforts, such as EITI, are seen as effective.

¶4. (SBU) To date, EITI in Peru has focused almost exclusively on mining, given that mining has long dominated the economy and in 2007 accounted for 62% of Peru's exports. With large investments in gas and Q1 underway, however, Peru is expected to become a net hydrocarbon exporter by as early as 2010. Many of these investments are taking place in isolated jungle communities that have had minimal contact with the modern world. The ability to use the resources that will be generated from royalties remains limited in these remote areas. While little attention has been paid to date on Peru's oil and gas sector, this area is ripe for additional work under EITI to head off potential conflict and plan in advance for the effective, transparent, and sustainable use of resources that will be generated.

15. (SBU) Peru is currently undergoing tectonic shifts as it moves to decentralize resources and decision-making to the regions while also modernizing the state. A national integrated financial management system, a new electronic public procurement process, and mandatory government websites at all levels are effectively shedding light on how government does business.

16. (SBU) With these new modern systems coming on line, both in Lima and the regions, a greater emphasis is being placed on efficiency and transparency. Staffers repeatedly heard that "big picture" transparency is not a problem in Peru. GOP websites provide information on how much the extractive industries provide in tax revenues and how these funds are allocated between the different levels of government. While there is variation among the level of financial detail private companies report, with publicly traded companies and larger firms being generally more open, an abundance of information exists.

Is Transparency the Easiest Part?

17. (SBU) Of greater concern in Peru are the "downstream" problems resulting from growing levels of transparency. Record mineral

prices in today's global market are generating unprecedented wealth for Peru. Through the state's ongoing decentralization effort, 50% of the royalties generated through extractive industries are made available to the regions. According to the GOP, 2007 mining royalties resulted in more than \$1.8 billion being transferred to regional and local governments, representing a budget increase of more than 1,700% for some districts.

18. (SBU) While the transfer of much-needed resources to the regions is seen as a positive step, problems are emerging around the perceived inequality of royalty distribution. Current legislation mandates that royalties must be returned only to those regions where the extractive companies operate. The regional government of Ancash, for example, received \$140 million in 2007 royalties. The contiguous region of Lambayeque received 250 dollars in the same year.

19. (SBU) As the royalty pie grows larger each year, calls from regional presidents in non-mining areas are becoming increasingly strident for legislative revisions that more equitably divide the funds among all of Peru's 25 regions. The natural wealth being extracted, it is argued, belongs to the entire country of Peru, not only to a handful of regions. In June, for example, a protest between two regions over the distribution of mining royalties closed the Pan-American Highway. Escalating violence eventually led to dozens of police being taken as hostages. While the protest and royalty issues have been resolved for the moment, tensions continue to simmer beneath the surface.

Conflict at the Local Level

110. (SBU) While debate about how to divide resources continues at the national and regional levels, the day-to-day impact of increasing royalties and greater transparency is being played out in the local municipalities. GOP officials and NGOs continually expressed to the Staff their concern about the capacity of local governments to effectively use the royalties to deliver benefits to some of Peru's poorest citizens. Specifically, many questioned the capacity of local officials to plan, develop, and implement public investment projects.

111. (SBU) Although Peru is shifting towards a more decentralized state model, the slow move away from a notoriously laborious and burdensome public bureaucracy continues to impede local investment projects. In addition, the capacity of municipal leaders, especially in the most remote and least developed regions (i.e., the Sierra Highlands), remains low. Local officials in these areas have limited access to the technical expertise needed to plan and develop sustainable projects. As royalties continue to expand each year, governments in the richest regions are saddled with large surpluses

they cannot spend.

¶12. (SBU) Interlocutors positively emphasized that the system is transparent enough for people to see the surpluses, which in turn puts pressure on politicians to improve performance. It is also, however, feeding resentment among some citizens who claim to see no substantive change in their lives, despite the windfall of resources. The Peruvian Office of the Ombudsman tracks ongoing social conflicts in the country, and in June 2008 it reported that more than 100 conflicts currently exist. Half of these are related to the extractive industries.

COMMENT

¶13. (SBU) The difficulties Peru is facing in the extractive industries show how to show tangible benefits on the ground from booming mineral prices - is a microcosm of the broader challenges that Peru faces. The relatively high degree of transparency and modernizing e-governance systems bode well for Peru's management of these issues. While the mining sector is moving along in its efforts to address transparency and the efficient use of extractive resources, the oil and gas industry remains at a more incipient stage. EITI is one tool that can help address some of the challenges identified. Perhaps its greatest value, now being piloted, will lie in its ability to bring government, civil society, and the private sector to the table to temper expectations and better manage the potential for conflict. END COMMENT.

McKinley